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AIRGRAM

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FROM : Department of State

SUBJECT : Oil Agreement in Libya

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SUMMARY

Agreement was reached on April 2 between the Libyan government and most oil companies operating there on new financial terms for oil production and exports. Under the agreement tax and royalty payments to the government will rise about 63 cents per barrel. Total income to the government at the current rate of production, will be increased from about $1.3 to over $2 billion dollars this year. All or nearly all of this cost increase is expected to be passed on the consumers in higher prices.

The agreement represents a major achievement for the Libyans who won not only a whopping increase in revenue from the companies on terms somewhat better than those agreed upon by companies at Tehran for Persian Gulf exports, but also gained a premium for the low sulphur content of their crude, a commitment by the companies to reinvest a certain amount in exploration or oil field improvement, and a payment in compensation for what the Libyans regard as underpayment of taxes and royalties by companies prior to September 1970.

For their part, the companies have preserved their oil concessions in Libya, avoided disruptions in their production and exports, and gained an agreement which will last in theory for five years on terms that they can live with and which will not greatly undermine the five year agreement reached in Tehran. The possibility of a further rapid upward spiral of oil costs and prices as occurred in the past seven months due to pressures from member governments of the

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Organization of Petroleum Exporting Countries (OPEC) is therefore minimized. END SUMMARY

Principal features of the Tripoli agreement are as follows:

Tax reference prices:

a. Base price. The tax reference price (posted price) for 40 degree API crude was raised almost 90 cents from $2.55 to $3.447 per barrel (see Table I). This includes the 35 cent general increase agreed upon at Tehran, a 7 cent increase which can be justified only on the basis that it was necessary to get the Libyans to make the deal, plus a premium of 10 cents in recognition of the low sulphur content of Libyan crude which makes it more desirable from the point of view of combating air pollution. (The actual value of low sulphur crude is difficult to calculate, but the cost of desulphurizing 3 percent sulphur crude down to the level of Libyan crude -- which is less than 0.5 percent sulphur -- is about 50 cents per barrel). Added together, this gives a total basic tax reference price of $3.07.

b. Escalations. On top of the base price was added an escalation factor of 12.7 cents, which is two and one-half percent of the base price plus 5 cents. This is the same percent and amount agreed on at Tehran. In theory it is supposed to compensate the oil exporting countries for the decreasing purchasing power of their oil income due to inflation in industralized countries. The first escalation for inflation takes place immediately, giving an effective base tax reference price of $3.197. Similar escalations will take place on the first of January 1973, 1974, and 1975. The first escalation was to have taken place on January 1, 1972, but was moved up to the effective date of the agreement (March 20, 1971) in order to get the Libyans to give up their demand to make the effective date of the agreement January 1, 1971.

A further increase of 2 cents per barrel in the tax reference price will take place on the first of January 1972, 1974, and 1975, supposedly to reflect the increasing value to consumers of low sulphur crude.

c. Temporary increases. On top of the new base price (including the first inflation escalation) of $3.197 was added a 13 cent temporary freight premium to reflect the current high rates prevailing for tankers, and 12 cents "Suez" premium to reflect the transportation advantage of Libyan oil over Persian Gulf oil as long as the Suez Canal remains closed. The total 25 cent temporary increases adds up to the current total posted price of $3.447.

The freight premium will be adjusted quarterly to reflect tanker rates, based on quoted rates for AFRA large range II (AFRA LR-II) which is for tankers of 80,000 to 160,000 tons dwt. Tanker rates are quoted in percentage terms of an ostensibly "normal" rate, which is Worldscale 100. Worldscale 50 is half that rate and Worldscale 200 is twice that rate, and so on. The Libyan agreement provides for an increase in the tax reference price of .058 cents per barrel for each .1% of Worldscale above Worldscale 72. In other words when the AFRA LR-2 rate drops to Worldscale 72 the temporary freight premium will be completely eliminated. Should the Suez Canal be reopened, the AFRA LR-2 rate is expected to drop down to or below Worldscale 72. The current rate is about W 95. Eight cents of the 12 cent Suez premium is to be eliminated when the Canal reopens to take commercial ships with a draft of 37 feet. When the Canal can accomodate ships of 38-feet draft, the remaining 4 cents will be removed. In the unlikely event that the Canal reopens to take ships with a 37-feet draft but the Suez Canal authority announces no plans for deepening the Canal further, the entire 12 cents will be eliminated anyway.

Tax Rate and Retroactivity:

There is now a uniform tax rate for all companies in Libya of 55%, except for the Occidental Petroleum Company which will pay 60%. The general increase in tax rates in Libya from 50% to about 55% which took place in September 1970 was agreed upon by the companies instead of making large payments for retroactive increases in the tax reference price which the Libyans claimed (with some reason) had been too low up until then. The companies were willing to pay the higher tax rate, which could be passed on to customers in higher prices, rather than making a huge lump sum settlement for past under-payment of taxes and royalties on oil already sold, which would have been more difficult to recover from the market. However, when the oil companies subsequently agreed to increase the basic tax rate from 50% to 55% for Persian Gulf exports, the Libyans claimed they should then get a 60% tax rate since they viewed five percentage points of their tax rate as payment in lieu of the retroactive payment and not as part of the basic tax rate. To get around this problem the companies agreed in Tripoli to a 55% tax rate plus a surcharge on top of the usual taxes and royalties which would represent a "buy-out" of the Libyan retroactive claim. This surcharge varies from company to company but averages about 9.2 cents in per barrel government revenue (not in the tax reference price) in perpetuity.

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Reinvestment:

Companies agreed to reinvestment in Libya to the extent of keeping one drilling rig in operation for each company or group of companies operating as a unit for each of the five years of the agreement. In the event that a company determines that proved or possible structures do not exist in its concession areas which are worth drilling, that company will invest an equivalent amount in gas reinjection or secondary recovery operations.

Price Increases to Consumers:

As already noted, the Libyan agreement will cost companies about an extra 63 cents per barrel in taxes, royalties, and the "buy-out" surcharge for 40 degree API crude. All or almos all of this will be passed on, or perhaps already has been sed on, to consumers in higher prices. As there are 42 U llons per barrel, this cost increase comes to about 1.5 s per gallon of crude, although the price increase for sp c products will vary from product to product and in ac nce with market conditions.

Table III shows the landed cif prices before duties of 40 degree API Libyan crude in New York and Rotterdam for 1971 through 1975, assuming a constant profit of 30 cents per barrel (which is in line with current profit rates). Prices are shown with both the current high tanker rates and the Suez Canal closed and prices with lower tanker rates and the Canal open. The freight costs from Libya to either New York or Rotterdam are almost the same. Figures from the Table indicate that the price of Libyan crude delivered in the market would drop 22 cents per barrel if the Canal were reopened. This assumes of course that the companies do not use the lower costs following reopening of the Canal to increase their profit margins, which is by no means certain.

Comparison of Libyan and Persian Gulf Settlements:

As shown in Table IV below, the cost to an integrated international oil company of Persian Gulf and Libyan crude delivered in the northern European market at Rotterdam (before profits) is now roughly the same as long as tanker rates remain at their present level and the Suez Canal remains closed. In southern Europe at Genoa, Libyan crude may still enjoy a cost advantage over Persian Gulf crude. However with a reopening of the Canal to take ships in both directions (a Suez/Suez voyage), or even a reopening of the Canal to a depth to take ships only one way on the return trip in ballast (a Cape/Suez voyage), Persian Gulf crude will cost about a 20 cent per barrel less than comparable Libyan crude in Northern Europe.

Also shown in Table V for the possible interest of posts is the method of calculating per barrel government revenue.

Government Revenues:

The figures in Table II for total and per barrel were only for one typical Libyan crude (40 degree API). Actual payments to the Libyan government in 1971 will be somewhat less because the price increase came into effect only on March 20 and because there are other crudes produced in Libya which command lower prices.

Industry estimates of actual total and per barrel payments to Libya and governments of other principal Middle East oil exporting countries in 1970 and 1971 are shown in Table VI. The table indicates that aggregate oil revenue to Libya and Middle East governments will increase almost 50% in 1971 above the 1970 level, from about $5.8 billion to about $8.3 billion. The estimates for Iraq and Saudi Arabia include offers made to those countries by companies for increased revenue for oil exported by pipeline to the Mediterranean; however, these offers have not yet been accepted. Estimates of revenue from oil exported from Persian Gulf oil ports are based in the Tehran agreement of February 14, 1971.

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Enclosures:

Tables I through IV

Table I — April 2 Libyan Agreement

Per barrel increases in tax reference prices (posted prices) for 40° gravity, API crude effective 3/20/71.

Base Posted Price as of 3/19/70	$	2.55
general increase		.35
"special" factor		.07
low sulphur premium		.10
New Base posted price	$	3.07
First year escalation, effective immediately, @ 2 1/2% of new base plus 5 cents		.127
New Permanent posted price	$	3.197
Variable Factors		
Suez factor		.12
transportation factor		.13
Current posted price	$	3.447

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Table II Posted Prices and Revenues. 40 degree API Libyan Crude

	March 20 1971	Jan 1 1972	Jan 1 1973	Jan 1 1974	Jan 1 1975
posted price, canal closed, W95 in dollars	3.447	3.467	3.618	3.773	3.932
Government take per barrel in dollars	2.050	2.056	2.148	2.242	2.338
Total Government revenue[1/] in billions of dollars	2.32	2.33	2.43	2.54	2.64
posted price, canal open, W72	3.197	3.217	3.368	3.523	3.682
Government take per barrel[1/] in dollars	1.893	1.905	1.996	2.090	2.187
Total Government revenue in billions of dollars	2.14	2.15	2.26	2.36	2.47

1/ Assuming constant level of exports of 3.1 million barrels per day. See also Table VI

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Table III Landed price of 40 degree API Libyan Crude in New York or Rotterdam in dollars per barrel

	1971	1972	1973	1974	1975
I. Canal closed, W90					
payment to government	$2.05	2.06	2.15	2.24	2.34
production costs	.25	.25	.25	.25	.25
profit	.30	.30	.30	.30	.30
transport	.35	.35	.35	.35	.35
pre-tax landed price	$2.95	2.96	3.05	3.14	3.24
II. Canal open W72					
payment to government	$1.89	1.91	2.00	2.09	2.19
production costs	.25	.25	.25	.25	.25
profit	.30	.30	.30	.30	.30
transport	.28	.28	.28	.28	.28
pre-tax landed price	$2.72	2.74	2.83	2.92	3.02

Note: Assuming government revenues of $2.00 per barrel and oil companies profits of 30 cents per barrel, the so-called "profit split" in Libya comes to about 87% to 13% in favor of the government.

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Table IV Comparison of costs to major international company of typical Persian Gulf and Libyan crudes delivered in Europe, 1971-72

I. At Worldscale 90, Canal Closed, cape/cape voyage from Persian Gulf

	34° Arabian light	40° Libyan
payment to government[1/]	$ 1.32	$ 2.05
cost of production	.12	.25
transport cost to Rotterdam	1.09	.34
	$ 2.53	$ 2.64
Adjustments[2/]	.11	
	$ 2.64	

II. At Worldscale 72, Canal Open

	34° Arabian light Suez/Suez	34° Arabian light Cape/Suez	40° Libyan
payment to government	$1.32	1.32	1.89
cost of production	.12	.12	.25
transport	.54	.63	.28
Suez Canal Toll[3/]	.12	.04	-
	$2.10	$2.11	$2.42
Adjustments[2/]	.11	.11	
	$2.21	$2.22	

1/ Based on the posted price for 34 degree API Light Arabian crude which will be in effect from June 1, 1971 to January 1, 1973, and the mean payment to the Libyan government during the same period.

2/ Assuming 5 cent per barrel greater value of Libyan crude due to 6 degrees API differential and 6 cent greater value due to low sulphur, reflecting a 9 cent and 10 cent differential in posted prices due to gravity and low sulphur, respectively.

3/ Based on Suez Canal toll prevailing before June 1967, which cost 90 cents per long ton (11.9 cents per barrel of 34 degree API crude) for round trip voyage. Cost of toll for ship transiting canal one way in ballast was assumed to be 30 cents per long ton.

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Table V Sample derivation of per barrel government revenue for 40 degree API Libyan crude

	1971
base posted price	$ 3.197
Suez premium	.120
freight premium	.130
Total posted price	$ 3.447
royalty @12 1/2% of total posted price	$ (.431)
production cost	(.250)
tax base	2.766
tax @55% of tax base	1.527
Government Take	
tax	$ 1.527
royalty	.431
surcharge	.092
Total government take	$ 2.050

Table IV Estimated Actual Oil Revenue Payments to Governments 1970-1971

	Total Revenue in billions of dollars		Revenue per barrel in dollars	
	1970	1971	1970	1971
Libya	$ 1.3	$ 2.028	$ 1.09	$ 1.86
Iran	1.106	1.8	.83	1.31
Iraq	.511	.750	.936	1.30
Kuwait	.891	1.3	.823	1.30
Saudi Arabia	1.228	1.7	.89	1.32
Sheikhdoms	.538	.735	.88	1.34-1.38
	$5.574	$8.313		

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ALL OECD CAPITALS INCLUDES THE FOLLOWING POSTS:

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THE HAGUE
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HELSINKI
EC BRUSSELS
MADRID
LONDON
LISBON
LUXEMBOURG
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COPENHAGEN
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